COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts.	D.T.E. 01-20 (Part A)

REPLY BRIEF OF WORLDCOM, INC.

EXECUTIVE SUMMARY

Five years ago, the Massachusetts Department of Telecommunications and Energy (the "Department") was one of the first state utility commissions to complete a cost case to establish unbundled network element ("UNE") rates. The Department had few precedents to follow and in many instances applied traditional costing principles that, as it turns out, generated UNE rates that far exceed the relevant costs and have thwarted development of a competitive market for local residential telecommunications services in Massachusetts. Now, the Department has another opportunity to set rates that fully comply with the Telecommunications Act of 1996 and the Federal Communications Commission's ("FCC") implementing rules. This review comes at a critical juncture for the nascent local competitors in Massachusetts including WorldCom. WorldCom now provides local services to business customers in parts of the Commonwealth. We await new UNE rates that might facilitate our offer of local services to residential customers on a statewide basis. If residents are ever to enjoy the benefits of local competition it is

essential for the Department to adopt rates based on the costing methodology mandated by the FCC. That methodology remains Total Element Long Run Incremental Cost ("TELRIC"). Unlike five years ago, there now are detailed pronouncements from the FCC and several Federal Courts describing the TELRIC methodology. These statements should guide the Department's deliberations.

The United States Supreme Court already has affirmed that the FCC has the authority to establish the UNE costing methodology. The Court now is considering whether TELRIC is an appropriate methodology. If it approves TELRIC, the question of methodology will be resolved. If it rejects TELRIC, and remands the matter for further consideration, TELRIC will remain the standard until it is replaced. The replacement methodology, if one were necessary, would almost certainly not be available until 2004. The industry needs, and the Department promised, a decision long before then. Therefore, TELRIC is, and will remain, the mandated cost methodology for this case.

Thus, the Department again faces and must answer the seminal question of "What is a TELRIC cost study?" The parties return with largely the same arguments heard five years ago. Verizon asserts TELRIC should reflect the costs of its current network augmented, as it might be three years from now. WorldCom asserts UNE rates must be based on the cost of a network built from scratch to serve the total demand that Verizon anticipates during the study period. Fortunately, as recently as in its approval of Verizon's 271 application in Rhode Island, the FCC has declared TELRIC requires a forward-looking network built from scratch and has commented on other key inputs.

Verizon's cost studies and inputs fail the first test the Department must apply: the studies violate TELRIC. At its most basic level, TELRIC is a particular application of a universally-recognized economic principle: one way to measure the value

of a good or service is to go out into the market and price a good or service that performs the same functions as the thing you want to value. Such "forward-looking" measures of value avoid having to consider the price once paid for the item (historical cost), and the many problems inherent in such a method of valuation, problems such as considerations of whether the original investments were prudently incurred, whether the books are accurate, and whether reductions in value caused by new technological developments have been accurately captured in depreciation schedules.

The heart of TELRIC is found in FCC rules that embody this forward-looking pricing concept. First, TELRIC requires that prices be set based on "forward-looking cost over the long run," 47 C.F.R. § 51.505. Second, and related, the rules state that these costs "should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the ILECs' wire centers." 47 C.F.R. § 51.505(b)(1).

Verizon's studies, however, do exactly what TELRIC proscribes: they take as a given Verizon's existing network, and then model the changes and additions Verizon asserts it will make to that network over the next three years. The models and inputs thus are not intended to model a hypothetical efficient network based on Verizon's existing wire centers. As such, they do not model what it would cost today to provide the functions that Verizon's network provides, and so are not designed to measure the value of Verizon's network as TELRIC requires. Instead they measure costs Verizon faces as it adds to its existing network. This measurement is not a TELRIC measure of value. It is as if a homebuyer asked the cost of a new home and was told instead the cost of her existing house with modernization.

Although here Verizon claims its models and inputs are TELRIC, it well understands that they are not. At the Supreme Court, speaking definitively through its General Counsel, Verizon expressly acknowledged that the critical feature of TELRIC is that it "explicitly rejected any measure tied to the incumbent's actual network and present or future cost structure," *IUB Br.* at 3, and that it "necessarily ignores the reality that the incumbent has an existing network whose future capital costs and operating expenses are in large part dictated by the network's current configuration." *Id.* at 11. So when it tells the Department that its model here does not "ignore completely its existing facilities and instantaneously replace them all with today's least-cost technologies" Br. 14, it is conceding that its model is not TELRIC. When its General Counsel tells the United States Supreme Court that "the FCC's methodology asked what particular elements would cost if the entire telephone network were rebuilt from scratch, as though writing on a blank slate," *IUB Br.* at 5., its concession here that the model it produced to the Department used as a "starting point of the investment analysis . . . an existing network rather than a blank slate," Verizon Br. at 14, is a concession that its model is not a TELRIC model.

Because Verizon's models and inputs, by Verizon's own admission, so obviously violate TELRIC, it would be unlawful for the Department to rely on them to generate network element prices. And when Verizon criticizes WorldCom and AT&T for doing exactly what Verizon told the Supreme Court the TELRIC rules require, that merely confirms that the rates proposed by WorldCom and AT&T are TELRIC rates.

When the Department rejects Verizon's view of TELRIC and instead follows the methodology as prescribed by the FCC, it must resolve the remaining critical issues as advocated by WorldCom. The Department:

?? Again must adopt the FCC prescribed depreciation rates;

?? Should adopt the 9.54% cost of money proposed by WorldCom recalling the FCC favorably commented on the 9.5% value adopted in Rhode Island and that the New Hampshire PUC recently adopted 8.42%.

?? Should adopt switching costs based on 100% use of the "new switch" discount;

?? Include switch minutes of use for 365 days, not just business days;

?? Adopt the Engineer, Furnish and Install ("EF&I") factors proposed by WorldCom;

?? Reflect loop growth in demand as well as capacity calculations;

?? Should adopt fill factors proposed by WorldCom;

?? Must adopt the loop model proffered by AT&T because Verizon did not propose a TELRIC-compliant loop model;

?? Must use only GR-303 compliant digital loop carrier; and,

?? Use consistent SONET node counts when calculating transport costs.

These and many other inputs are discussed more fully in the testimony and briefs sponsored by WorldCom.

WorldCom encourages the Department to reach decisions that implement TELRIC as defined by the FCC and we ask the Department promptly to conclude this proceeding.